

Message Text

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S/S-O P.JOHNSON

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TO USDEL SECRETARY PRIORITY

S E C R E T STATE 305266 TOSEC 250092

NODIS

E.O. 11652: GDS

TAGS: ENRG

SUBJECT:MEMORANDUM TO SCOWCROFT ON TECHNICAL ASPECTS OF OIL
AGREEMENT WITH IRAN: BRIEFING MEMORANDUM

FOR THE SECRETARY FROM ROBINSON

1. AS YOU KNOW, AFTER YOUR DEC. 19 MEETING WITH THE PRESIDENT AND RUMSFELD ON THE PROPOSED IRAN OIL DEAL, SCOWCROFT ASKED ME AND ELLSWORTH TO TRY TO RESOLVE TECHNICAL AND OPERATIONAL ISSUES SO THAT ONLY BASIC POLICY QUESTIONS WOULD REMAIN FOR FURTHER CONSIDERATION. SCOWCROFT, AFTER TALKING WITH YOU TODAY, HAS CALLED FOR A MEMORANDUM REPORTING THE RESULTS OF STATE-DOD CONSULTATION ON TECHNICAL ISSUES BY COB TODAY.

2. ACCORDINGLY, I HAVE OBTAINED ELLSWORTH'S AGREEMENT TO THE FOLLOWING MEMORANDUM AND HAVE GIVEN IT TO SCOWCROFT WITH THE UNDERSTANDING THAT IT IS SUBJECT TO YOUR REVIEW. NOTE THAT MEMORANDUM ALSO EXPRESSLY RESERVES YOUR INNINGS ON POLICY ISSUES.

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3. TEXT FOLLOWS:

SUBJECT: TECHNICAL AND LEGAL FEASIBILITY OF PROPOSED BILATERAL OIL AGREEMENT WITH IRAN

AS YOU REQUESTED, BOB ELLSWORTH AND I HAVE CONCERTED VIEWS ON THE TECHNICAL AND LEGAL ASPECTS OF A BILATERAL OIL ARRANGEMENT WITH IRAN, AS OUTLINED TO THE PRESIDENT BY SECRETARY KISSINGER ON DECEMBER 19. WHILE RESERVING THE RIGHT OF OUR RESPECTIVE SECRETARIES TO COMMENT ON POLICY ASPECTS OF THE PROPOSAL, WE HAVE AGREED THAT THE ARRANGEMENT WOULD BE FEASIBLE IF THE KEY TERMS NOTED BELOW WERE ACCEPTED BY THE GOVERNMENT OF IRAN.

A. KEY TERMS OF AGREEMENT

1. THE AGREEMENT WOULD BECOME OPERATIVE UPON THE ENACTMENT OF A U.S. APPROPRIATION UNDER THE DEFENSE PRODUCTION ACT. THIS APPROPRIATION WOULD NEED TO BE ABOUT 350 MILLION DOLLARS, EQUAL TO THE INITIAL 60 DAYS OF PURCHASES OF IRANIAN CRUDE UNDER THE AGREEMENT, AFTER WHICH RECEIPTS FROM SALES TO REFINERS SHOULD REGULARLY EXCEED OUTLAYS. (A DOD LEGAL OPINION NOW HOLDS THAT AUTHORIZING LEGISLATION FOR THE CREATION OF A SPECIAL REVOLVING FUND MAY BE NECESSARY. STATE DISAGREES. THE ISSUE WILL BE REVIEWED URGENTLY.)

2. BASE PRICES WOULD BE ESTABLISHED IN THE AGREEMENT FOR IRANIAN LIGHT AND HEAVY CRUDE AT PRICES CURRENTLY COMPETITIVE WITH THE LOWEST CURRENT INTERNATIONAL MARKET PRICES, TAKING INTO ACCOUNT QUALITY AND SHIPPING FACTORS, RATHER THAN PRESUMING THAT THE CURRENT IRANIAN SELLING PRICES ARE NECESSARILY COMPETITIVE. (THE BASE PRICES SO ESTABLISHED WOULD BE FIXED FOR THE FIVE YEARS OF THE AGREEMENT. WE WOULD SEEK AGREEMENT LANGUAGE MAKING THEM SUBJECT TO A CONTINUING TEST OF COMPETITIVENESS.)

3. LIMITED INDEXING ADJUSTMENTS IN ESTABLISHED BASE PRICES WOULD BE PROVIDED FOR IN THE AGREEMENT, COMMENCING JULY 1, 1976 AND AT SIX-MONTH INTERVALS THEREAFTER, IN
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THE SAME PERCENTAGE AS THE U.S. WHOLESALE PRICE INDEX (FOR ,ALL COMMODITIES") RISES OR FALLS IN THE PRECEDING SIX MONTHS; PROVIDED, HOWEVER, THAT THE ADJUSTED BASE PRICES COULD NEVER EXCEED THE THEN PREVAILING IRANIAN SELLING PRICES TO OTHER CUSTOMERS.

4. PRICE DISCOUNTS OF APPROXIMATELY 50 CENTS PER BARREL BELOW THE ESTABLISHED AND ADJUSTED BASE PRICES WOULD BE

FIXED BY THE AGREEMENT. THE DISCOUNTS WOULD BE IN ADDITION TO THE FINANCIAL EQUIVALENT OF THE NORMAL 45-DAY INTEREST-FREE CREDIT TERMS. (DOD'S POSITION IS THAT WE SHOULD NEGOTIATE AS GREAT A DISCOUNT AS POSSIBLE. ELLSWORTH BELIEVES THE DISCOUNTS OUGHT TO BE AT LEAST 2 DOLLARS.

I EXPECT THE TOTAL OF FIXED DISCOUNT AND LIKELY PRICE DIFFERENTIALS UNDER THE AGREEMENT AS PROPOSED TO RISE TO ONE DOLLAR OR MORE BY NEXT FALL.)

5. PAYMENT TERMS WOULD BE CASH BY DOD TO THE NATIONAL IRANIAN OIL COMPANY (NIOC) WITHIN 15 DAYS OF RECEIPT BY DOD OF EACH MONTHLY SUPPLY OF NIOC CRUDE OIL CONTRACTS. (PAYMENT TERMS ON SALES BY DOD TO U.S. REFINERS WOULD BE SET AFTER CONSULTATION WITH CRUDE MARKETING SPECIALISTS, BUT OUR PRESENT THINKING IS TO PROVIDE A UNIFORM 60-DAY INTEREST-FREE DEFERRAL OF PAYMENT, CONSISTING OF THE NORMAL 45 DAYS PLUS AN AVERAGE 15 DAYS BETWEEN CONTRACTING AND LIFTING OF OIL.)

THE EXPECTED EFFECT OF THE PAYMENT AND PRICE TERMS OUTLINED ABOVE WOULD BE TO GUARANTEE AGAINST FISCAL LOSSES BY DOD IN OPERATING THE PROGRAM. THE FIXED DISCOUNT WOULD ALWAYS BE FREE AND CLEAR AND, HOPEFULLY, MORE THAN SUFFICIENT TO INDUCE REFINERS TO BUY THE CONTRACTS. (DOD BELIEVES THE FOREGOING CAN ONLY BE DEMONSTRATED BY A CONTINUING TEST IN THE MARKET PLACE.) IN ADDITION, WE EXPECT THE LAGS IN SEMI-ANNUAL PRICE ADJUSTMENTS AND THE DIFFERENTIAL BETWEEN THE ADJUSTED PRICES AND PREVAILING OPEC PRICES TO YIELD A GROWING PRICE ADVANTAGE FOR THE US. IF THE PROGRAM WORKS AS EXPECTED, THE ONLY CONCEIVABLE DOD "LOSS" WOULD RESULT FROM GREAT SUCCESS, THAT IS, IF THE OPEC PRICE FRONT COLLAPSED DURING A MONTH AFTER DOD HAD

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TAKEN NIOC CONTRACTS AT THE FORMULA PRICE. SUCH A PRICE COLLAPSE WOULD YIELD GREAT FISCAL BENEFITS TO DOD, AND GREAT ECONOMIC BENEFITS TO THE U.S. ECONOMY GENERALLY, OVER THE FOLLOWING MONTHS, SO THAT NO LONG-TERM LOSS WOULD RESULT.

B. PROGRAM OPERATIONS

-- THE PRESIDENT DELEGATES TO THE SECRETARY OF DEFENSE AUTHORITY TO CARRY OUT THIS PROGRAM UNDER THE DEFENSE PRODUCTION ACT AND THE SUPPORTING APPROPRIATION ACT.

-- NIOC ISSUES TO DOD AT THE FIRST OF EACH MONTH (OR QUARTERLY, AS MAY BE AGREED), SPECIAL CONTACTS (BEARER OR ASSIGNABLE) TOTALLING 15 MILLION BARRELS IN CONVENIENTLY

DENOMINATED QUANTITIES OF SPECIFIED TYPES OF IRANIAN CRUDE, IN THE MOST FAVORABLE RATIO OF HEAVY AND LIGHT CRUDE WHICH IS NEGOTIABLE.

-- DOD DRAWS ON THE REVOLVING FUND ESTABLISHED BY A SPECIAL APPROPRIATION UNDER THE DEFENSE PRODUCTION ACT TO PAY FOR THESE CONTRACTS AT THE AGREEMENT FORMULA PRICES

THEN OBTAINING, WITHIN 15 DAYS OF RECEIPT OF THE CONTRACTS FROM NIOC.

-- DOD OR ITS AGENT AUCTIONS THESE CONTRACTS TO U.S. COMPANIES OPERATING REFINERIES IN THE UNITED STATES OR OPERATING OFFSHORE REFINERIES CERTIFIED BY FEA TO BE SUBSTANTIALLY DIRECTED AT SERVING THE U.S. MARKET. DOD, AT ITS OPTION, MAY RETAIN ALL OR PART OF THE CRUDE OIL AS "GOVERNMENT-FURNISHED MATERIAL" FOR DOD USE. (IN THE EVENT THE U.S. GOVERNMENT UNDERTAKES TO SUPPLY OIL OR PETROLEUM PRODUCTS TO ISRAEL OR OTHER COUNTRIES UNDER INTERNATIONAL SECURITY AGREEMENTS, THE RESTRICTION ON REFINERS ELIGIBLE TO BID FOR THE CRUDE UNDER THIS AGREEMENT MAY BE MODIFIED.) THE PAYMENT TERMS OFFERED BY DOD TO BIDDERS PROBABLY WILL BE CASH 60 DAYS AFTER PURCHASE OF CONTRACTS, AS EXPLAINED IN PARAGRAPH 5 (PAYMENT TERMS)

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ABOVE.

-- RECEIPTS FROM SALES ARE DEPOSITED IN THE REVOLVING FUND. EARNED SURPLUS IS HELD IN THIS ACCOUNT AS A CONTINGENCY FUND AGAINST SHORT-TERM LOSSES.

-- OIL CONTRACTS NOT SOLD DURING ANY GIVEN PERIODS ARE CARRIED FORWARD TO SUBSEQUENT PERIOD, UP TO A LIMIT FIXED IN THE AGREEMENT. (WE MAY SEEK A GENEROUS LIMIT ON CARRYOVERS IN THE INITIAL MONTHS AND ACCEPT A SMALLER LIMIT THEREAFTER.)

C. OTHER TECHNICAL ISSUES

A VARIABLE FACTOR OF MAJOR IMPORTANCE IS THE TERMINATION PROVISION OF THE AGREEMENT. IRAN MAY WANT THE RIGHT TO TERMINATE IN THE EVENT IT FINDS THAT THIS PROGRAM IS DISPLACING ITS "REGULAR" EXPORTS TO THE UNITED STATES. IF IRAN INSISTS ON WEAKENING OUR PROPOSED PROVISION FOR A CONTINUING COMPETITIVE PRICE TEST (ON THE ESTABLISHED AND ADJUSTED PRICES), WE WILL HAVE TO COMPENSATE FOR THIS WITH A TERMINATION CLAUSE ACHIEVING MUCH THE SAME RESULT.

THESE AND OTHER ELEMENTS OF THE AGREEMENT ARE SUBJECT TO
TRADE-OFFS SO LONG AS THE END RESULT IS AN ARRANGEMENT
DESIGNED TO ACHIEVE OUR POLICY OBJECTIVES, AS OUTLINED
BY SECRETARY KISSINGER ON DECEMBER 19, AND TO AVOID NET
LOSSES BY DOD. ROBINSON

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